A Labor Paradigm for All Seasons

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I. *Introduction*

Our task is to provide an in-depth assessment of W. H. Hutt's *The Theory of Idle Resources*, published in 1939, almost sixty years ago.[1] Thus, this essay can be thought of as a retrospective review article. There is at least one major advantage to a project of this sort. We have the luxury of hindsight. We know what has happened since Hutt's book was published and, therefore, we can do more than just recite the specifics and themes of his effort. We can ask the broader questions, especially the most important one in the scholarly world, "How has it stood the test of time?"

II. *The Tenor of the Times*

In order to place *The Theory of Idle Resources* in perspective, a brief description of the milieu in which it appeared is appropriate. 1939 is an intriguing year. It marks both the end of a decade of economic trauma, the years of the Great Depression, and the formal beginning of the cataclysm known as World War II. These events combine to make it a significant time in the world of political and intellectual affairs. On the political side, the 1930s can be thought of as accelerating the rise of the modern state. In some jurisdictions, the phenomenon takes the form of the stern totalitarianism of the regimes that dominated such countries as Germany, Italy, the Soviet Union, and Japan. Elsewhere, what emerges is a softer, paternalistic form of totalitarianism that involves a wide variety of government forms of intervention in individual decision making. The rationale for the latter was often founded in the desperate economic circumstances of the decade. It was a time of crisis, and a crisis mentality can persuade people to accept forms of government interference in their daily lives that they otherwise would find intolerable.[2]

Much of the paternalistic totalitarianism of this time focused on labor market outcomes — jobs and wages. In the United States, for example, one of the major byproducts of public policy experimentation in the Great Depression years was an increase in the economic and political significance of trade unions. A series of legislative initiatives culminated in the National Labor Relations Act of 1935 (the Wagner Act) which conferred formal legal standing on labor unions. One of the justifications for this legislation was a naive form of underconsumptionist thinking that was quite prevalent in the 1930s, the idea that increases in money wage rates would stimulate spending on consumer goods and increase employment.[3] In the Policy and Findings

preamble to the act, it is asserted that the "unequal" bargaining power in nonunion situations "tends to aggravate recurrent business depressions, by depressing wage rates and the purchasing power of wage earners in industry" (Miller, 1948, p. 569).

Accompanying the granting of privilege to labor unions in the United States during the 1930s were a series of other interventions in the labor market — minimum wage laws and the institution of social insurance schemes are examples — designed to redistribute income from employers to workers. Certainly, by the end of the decade, a substantial government presence in economic affairs was widely accepted, in the United States in particular and in the West in general.

Developments on the political front during the 1930s were related in a synergistic fashion with the cultural environment of the time. Of course, the dominant intellectual event of the era was the publication of John Maynard Keynes's *General Theory of Employment, Interest and Money* (1936). By 1939, it had acquired widespread popularity. In 1947, future Nobel laureate Paul Samuelson (1947) reminisced about the era as follows: "The *General Theory* caught most economists under the age of 35 with the unexpected virulence of a disease first attacking and then decimating an isolated tribe of south sea islanders." What would later be described as The Age of Keynes was in its infancy — and it was a strong and lusty child.

The heart and soul of the intellectual framework espoused by Keynes is a repudiation of the notion that there is an underlying tendency for markets to produce equilibrium conditions in an economy that are consistent with the full employment of resources. His major focus was on the behavior of money wage rates in a modern economy, especially the linkage between money and real wage rates. At one point in the *General Theory*, he speculates that money and real wage rates move in opposite directions, (Keynes, 1936, pp. 9–10)[4] implying that normal market adjustments to the presence of a surplus of labor are *destabilizing*, not stabilizing. Declines in money wage rates would increase real wages, which even Keynes admits would reduce employment.[5]

Keynes's views on the relationship between real and money wage rates seem to be a fairly straightforward empirical proposition. However, there are indications that his attitude on this matter involves more than just a simple observation on the realities of the world. At another point in the *General Theory*, he makes the absolutely astounding statement, "It can only be a foolish person who would prefer a flexible wage policy to a flexible money policy" (Keynes, 1936, p. 268). The juxtaposition of the notions of flexible wages and flexible money as policy choices reflects his conviction that real wages can be reduced by increasing the price level through the use of monetary and fiscal policy. What this remark reveals is a normative predisposition against flexible money wage rates on the part of Keynes. This is confirmed in other passages from the *General Theory*, especially one at the beginning of the concluding chapter: "The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and income" (Keynes, 1936, p. 372).

The Keynesian distaste for money wage rates that are flexible, especially in a downward direction, was consistent with the already described political spirit of the period. It also meshed with a long-standing intellectual tradition that viewed "labor" as a special case, an input into the productive process whose price (wage) should not be subject to the vagaries of the competitive market place. That would be too demeaning.

All of these strands of thought and political action coalesced in the form of a conventional wisdom that embodied the following propositions:

(1) Competitive money wage rate adjustments have no useful economic function;

(2) Giving workers greater power (through trade unions) to set money wage rates is morally desirable and may serve the economic purpose of increasing aggregate purchasing power and employment;

(3) It is desirable to have government interference in labor markets to protect workers from the rigors of the competitive market place; and

(4) The truly effective way of assuring full employment of resources is through the manipulation of aggregate demand and the overall price level.

III. *The Message*

It was into this milieu that *The Theory of Idle Resources* made its appearance. Hutt was modest about the book. In the preface, he states that he, "does not claim to have made any direct contribution to monetary or trade-cycle theory," and that, "it is my hope that all sides in the current debate on the monetary causes of idleness will find my analysis realistic and useful" (pp. 23–24). In this section of our essay we describe, mainly through direct quotes, the nature of Professor Hutt's thinking on the subject of unemployment, especially the role of relatively inflexible, or "sticky" money wage rates in creating it. We hope that the quotations give the reader the essence of the book's contents.

For Hutt, it was not only monopoly power in the product and labor markets that caused sticky wages and prices. He has a rather complete treatment of why money wage rates tend to be rigid downwards because workers may prefer unemployment to wage reductions. A major thrust of this discussion is that much of what is generally viewed as "involuntary" unemployment is really voluntary in nature. He points out that a lower salary may so hurt a worker's pride that he would choose idleness over work. The nature of the work may be such that idleness is preferred. The disutility of work might be too high, especially if custom or public opinion condones or does not condemn idleness (p. 108). "The preference of idleness may depend upon attachment to a district where an individual has relatives or friends and a customary mode of living" (p. 109). Unemployment from these sources is by preference, he says. "It implies no wrong use of resources, given the social will. If it is a condition which we happen to deplore on moral grounds, then that method of reform lies either in changing the preferences directly (through preaching or teaching) or in changing the environment

which apparently gives rise to the despised preferences" (p. 110). Also, "preferred idleness may arise through a preference for jobs giving intermittent leisure," and "the intermittent leisure may be an end for which a sacrifice will be made" (p. 112). He further mentions that it has been known for a long time that the availability of income without work is a "stimulus to unemployment" (p. 111).

It annoyed Hutt immensely that Keynes claimed that his predecessors believed that the supply of labor was purely a function of the real wage rate. Keynes asserted that classical economists assumed that "all those who are now unemployed though willing to work at the current wage will withdraw their offer of labor in the event of even a small rise in the cost of living" (Keynes, 1936, p. 13). Hutt denied this, saying, "It is difficult to believe that many economists could have been so stupid" (pp. 136–37). He also said, "workers in general tend to be more concerned about wage-rates than about purchasing power of wages, and in depressions may collectively prefer unemployment to lower wage rates . . . In practice, their objection *as wage earners* to downward wage-rate adjustments seems to be more serious than their anger *as consumers* at price increases," and "concerning those already in employment, for example, so long as they receive the same money wage-rate they are relatively satisfied: what are usually called their 'real wages' matter little to them. Perhaps the importance of maintaining the nominal wage-rate lies principally in the fact that the dignity of the worker is thereby secured. He does not have to confess to reduced earning power. Moreover, all other workers are similarly burdened when the price of 'wage-goods' rises. His line of employment is not *singled out*, so to speak, for a wage cut, to the detriment of his status and self-respect" (p. 135).

We think that Hutt's motivation to write *The Theory of Idle Resources* was his great frustration with the Keynesians' unwillingness to acknowledge that their model's unemployment derived from sticky money wage rates rather than from a monetary maladjustment such as a too-tight monetary policy or a liquidity trap. Hutt says that Keynes seemed to think that wage setting via collective bargaining constituted an insurmountable barrier and that, "eliminating 'involuntary unemployment' can be obtained only through the 'real' earnings of labor being reduced in a *tactful* way, i.e., by leaving money wage rates untouched, a stratagem that can best be accomplished by inflating prices through monetary policy" (p. 209). Hutt insisted that "orthodox" economists did not take for granted the downward money wage rigidities induced by labor negotiations.

Let us offer one last, rather lengthy, quote to bolster our argument that his 1939 book was mainly written in response to Keynes's and the Keynesians's unwillingness to concede the crucial role played by money wage rate rigidities in their aggregate demand oriented model. He said, "Suppose the source of rigidity in the labor market has to be ascribed to the necessity for saving face and preserving the livelihood of trade union leaders; or suppose it is believed due to the fact that the finance of a large political party and the maintenance of an immediately purposeful and popular program necessitates the continued belief on the part of the masses that wage cuts repre-

sent the exploitation of the 'have-nots' by the 'haves'; or suppose we feel that the origin of such rigidity lies deeper and involves capital organization and ideologies as much as it does those of labor; are we, as practical economists or sociologists, to accept these facts as natural and inevitable and so treat them as fundamental assumptions? . . . If so, we must state that assumption explicitly. But as realistic students of society, we have to face the truth that such rigidities are based on institutions which appear to be within the power of society to change" (pp. 209–10).

With that quote, we have reached the essence of *The Theory of Idle Resources,* Hutt's conviction that governments should challenge the power of labor unions (perhaps through revised anti-trust laws) to amplify the rigidities emanating from the diverse psychological and sociological reasons for workers resisting market-induced money-wage reductions. Clearly, in Hutt's mind, the problem of unemployment had its origins in money-wage rates that were higher than warranted by the realities of the marketplace, in workers asking too much for their services. The difficulty he saw with the Keynesians was that they provided a too convenient *apologia* for the excesses of the unions. In an essay written some fifteen years later, he quite emphatically says, "Keynes's new teachings seemed to support strongly those who cried, 'Hands off the unions'" (Hutt, 1954).

IV. *The Response*

What was the general response to the propositions advanced by Hutt in *The Theory of Idle Resources?* Less than enthusiastic. For one, the publication of the book coincided with world-wide events that would very soon push the issue of idle resources off stage. When the troops marched in September 1939, inaugurating the most widespread conflict in history, there was a general shift toward organizing economies on a command basis, even in the relatively free Western world. The notion of redundant labor (unemployment) became redundant itself. Unemployment was transformed into armies marching off to battle. Idle factories provided the means of producing the ships, guns, and planes that this newest version of military struggle would require.

In such circumstances, the speculations and hypotheses of an academic economist in residence at a university located at the very southern tip of the African continent did not seem to be very important. This was reflected in the tone of the reviews in the academic journals. The major British periodical, the *Economic Journal,* published a review in December 1939. Written by L.M. Fraser, it begins with the terse sentence, "This is a short, stimulating and somewhat unsatisfactory book." About all that Fraser found useful was Hutt's taxonomy of "idleness." At the same time, his understanding of the real substance of *The Theory of Idle Resources* seemed to be uncomprehending. He boldly states that "no one should be misled by the imaginative statements contained on its dust jacket. It is not 'largely devoted to criticism of Mr. Keynes's *General Theory.*' It does not show that 'there must be complete freedom of competition to allow the price system to register consumers' wants.' It does not develop 'the theme of what type institutions are required by a competitive system.'"

A second review, in *Economica*, appeared in May 1940, just as the war in Europe entered some of its darkest phases. France was collapsing. There was a crisis in government. Dunkirk was on the horizon. This review was more gentle than Fraser's, being written by Arnold Plant, an old friend who had arranged Hutt's academic appointment in South Africa. However, it too missed the major thrust of his conceptual framework, focusing excessively, once more, on the taxonomy, the distinctions Hutt drew between the multiple forms of idleness.

By now, as the war deepened and expanded, the concern was not with a surplus of resources, but with a shortage of the wherewithal to produce the things needed to successfully engage in a modern war. This posed no problem for the advocates of the Keynesian world view. In fact, superficially, the shortage of resources, especially labor, during World War II could be interpreted as providing definitive empirical evidence that the Keynesian analytical framework was valid. After all, within the catechism of the Keynesian style income accounting equations, government outlays for military hardware were perfect substitutes for private investment expenditures. Apparently, stimulating aggregate demand through increasing public expenditures on goods and services did work.[6]

On the intellectual front, encouraged by the seeming success of public spending as a device to eliminate unemployment, tinkering with the Keynesian income equations proceeded apace. A spate of journal articles were erecting a seemingly impressive technical edifice that described the Keynesian system. One of these articles, in particular, is noteworthy — a piece by Franco Modigliani that appeared in the January 1944, issue of *Econometrica.* Titled, "Liquidity Preference and the Theory of Interest and Money," it provides an analysis that almost exactly mirrors the conventional wisdom that was described earlier, namely, that macroeconomic disequilibrium cannot be traced to inappropriate levels of money wage rates but to price and spending levels that are inconsistent with equilibrium. Not quite two decades down the road, thinking of this sort would be embodied in the ephemeral concept of the Phillips curve.

World War II did come to an end and, as the prospect of a cessation of hostilities became very real, economists began to express concern about what would happen in the post-war era. Among devout Keynesians, the issue revolved about the effect on macroeconomic activity of a cessation of government spending for military purposes. The American Keynesian, Alvin Hansen, simply asserted, "When the war is over, the Government cannot just disband the Army, close down munitions factories, stop building ships, and remove all economic controls" (Hansen, 1943, p. 5). Hansen saw disaster, a return to the depressed conditions of the 1930s, should government do all these things. Hansen was not alone in this view, especially in the United States. There, the overwhelming consensus was consistent with his position.[7]

The immediate post-World War II period in the United States provided a marvelous opportunity to evaluate the validity of both Hutt's and Keynes's views of the world. The United States did precisely all the things Alvin Hansen warned against. The end result was a dramatic decline in federal government spending and, arguably,

the most pronounced shift in fiscal policy in American history. From a 1944 federal government deficit amounting to about one-fourth of national output, the country moved to a surplus of more than five percent of total output by 1947. In the context of the Keynesian system, the impact of this change on the American economy should have been devastating. However, the abandoning of the war-time regulations permitted a flurry of money wage and commodity price adjustments that took the economy to levels of unemployment that had not been seen in peacetime since the 1920s. Hutt's perceptions of how economic systems functioned were validated and Keynes's were not. However, the American Keynesians were undaunted. They developed an ad hoc explanation for the immediate post-World War II events that relied on an alleged shift in the Keynesian consumption function resulting from a pent-up demand for goods and services.[8] Notions such as those embodied in *The Theory of Idle Resources* were simply ignored by the mainstream economic establishment which, by now, was more and more located in the United States. The Keynesian analytical framework was triumphant.

V. *The Test of Time*

The great potential equalizer for academics whose ideas are rejected and ignored by the academic profession of their age is time. As the years pass and events unfold, flawed theses have a way of unraveling before our eyes. In the case of Keynes's system, the critical time was the decade of the 1970s. During the preceding years, the 1960s, Keynesianism had reached its apogee as the full implications of Modigliani's 1944 article flowered in the form of the Phillips curve notion.[9] The Phillips curve was nothing more than a license to inflate prices in an economy in an effort to increase employment and output. Through the 1960s, the Phillips curve idea seemed to work, particularly in the United States. However, towards the end of that decade, it was challenged, especially by Milton Friedman (1968). And then, as the new decade began, it all collapsed. The supposedly stable Phillips curve relationship shifted, in line with the Friedman critique. We add that the possibility of such a shift is suggested in a passage from *The Theory of Idle Resources*. Hutt asks the prescient question, "Can workers in general be deceived 'for their own good' in a manner which will not necessitate further deceptions later on?" (p. 140).

Worse yet for the Keynesian framework, there were other assaults from the intellectual community. The questioning of the validity of the Keynesian analysis had begun within the mainstream of the academy. In particular, the concept of "rational expectations" (RATEX) commanded widespread attention.[10] Simply put, the notion of rational expectations applied to macroeconomic affairs generates outcomes that are quite consistent with the theoretical framework described in *The Theory of Idle Resources*. What emerges from the RATEX analysis is a macroeconomic world that is little more than an instantaneously adjusting classical model in which random forecasting errors temporarily may shock the economy out of full employment equilibrium.[11] Of course, in such a world, the economy will show a tendency toward

some underlying equilibrium state. This sounds very much like Professor Hutt's analysis in *The Theory of Idle Resources.* To be sure, Hutt's version is bereft of the technical nomenclature of the RATEX literature. Nevertheless, the ultimate essence of the two approaches to the way in which economic systems operate is the same.

Even among those who reject the RATEX approach, such as the so-called New Keynesians, there has been a sharp movement away from Keynesianism as outlined in the *General Theory.* Almost every textbook writer now describes the long-run aggregate supply curve as being perfectly inelastic, implying that a macroeconomic system has an internal mechanism that drives it toward a unique equilibrium position. A vertical long-run aggregate supply curve represents a total repudiation of the basic tenets of the *General Theory.*

In addition, there have been other recent developments which basically confirm Hutt's reasoning. Dan Benjamin and Kent Mathews (1992) and Richard Vedder and Lowell Gallaway (1993, 1994) have presented empirical evidence for Great Britain and the United States, respectively, that constitutes a powerful confirmation of Professor Hutt's conclusion that the source of unemployment is money wage rates that are inappropriately in excess of what is warranted by economic conditions. As Hutt put it in a 1984 interview, "depression is due to the process of asking too much for the outputs of men and assets" (Reynolds, 1985, p. 314).

Despite the ever increasing awareness that the Keynesian analysis is irreparably flawed, with one exception, the recognition of the role of Professor Hutt in producing the movement away from the pure Keynesian style of economic thinking has been somewhat minimal. An April 1996, computer search of the Social Science Citation Index revealed only 14 citations of *The Theory of Idle Resources* since 1971. We mentioned one exception. It is in the form of an appreciation of Hutt's contribution among modern-day Austrian economists. This is not surprising. There are strands of thinking among the Austrians that parallel Professor Hutt's analysis. Examples can be found in Ludwig von Mises (1953) and Murray Rothbard (1963).[12] Illustrative of the modern Austrian attitude towards Hutt's work is the following quote from one of their recent publications: "Hutt is the mirror image of the Keynesians. . . . [he] thought of himself as a classical economist, but . . . in the course of improving the classical model, he arrived at an essentially Austrian position on most issues" (von Mises Institute, 1996, p. 12).[13]

Fortunately, Professor Hutt lived long enough to see the vindication of his ideas, even though he was still slighted in terms of formal recognition.[14] Still, one author of an obituary expressed this sense of triumph as follows, "Hutt's ideas were to come into their own in the 1980s in Thatcherite Britain, Reaganite America and the 'social market'economy of Chancellor Kohl's Germany" (*The Annual Obituary*, 1988, p. 278). Can a scholar ask for much more than this? In *The Theory of Idle Resources*, William Harold Hutt provided a paradigm for all seasons.

NOTES

[1]A personal comment: Both of the authors of this essay knew Bill Hutt. Professor Klingaman remembers vividly Hutt as he arrived in the U.S. in December, 1965, to assume a position as Visiting Professor of Economics at the University of Virginia. He was a graduate student in the first course Hutt taught at Charlottesville, an economic development seminar that met twice weekly. As he remembers it, "On our first day in class, Professor Hutt announced that he would alternate his lectures between economic development and macroeconomics. Having only recently read his *Keynesianism: Retrospect and Prospect* (1963), this was a thrilling 'prospect' indeed. It was an exciting course, especially on the macro days!"

[2]For insight into this phenomenon, see Higgs (1987).

[3]Perhaps the most influential advocate of these ideas was Herbert Hoover, president of the United States from March 1929 to March 1933. For some details of Hoover's attitudes, see Rothbard (1963) and Vedder and Gallaway (1993, pp. 90–95).

[4]Keynes says, "It would be interesting to see the results of a statistical inquiry into the actual relationship between changes in money wages and changes in real wages. . . . in the case of changes in the general level of wages, it will be found, I think, that the change in real wages associated with a change in money-wages, so far from being usually in the same direction, is almost always in the opposite direction." When the statistical analyses came (see Dunlop (1938) and Tarshis (1939)) they did not confirm Keynes's intuition, but supported the notion that real and money wage rates moved together. However, this did not deter "true-blue" Keynesians. In 1947, Klein (1947, p. 107), in referring to the Tarshis study simply said, "Our main concern. . . . is not with the empirical problem but with the theoretical relation of wage cuts to unemployment."

[5]Keynes (1936, p. 17) unambiguously accepted the proposition that the *real wage* labor demand relationship is negatively sloped. His exact words are, ". . . an increase in employment can only occur to the accompaniment of a decline in the rate of real wages. . . . I am not disputing this vital fact which the classical economists have (rightly) asserted as indefeasible."

[6]In England, William Beveridge (1944), for example, wholeheartedly embraced the idea that the war experience demonstrated the viability of government spending as a means of achieving full employment. In commenting on a 1944 government White Paper on employment policy, he dismissed a long-held Treasury position, which he described as dogma, that no permanent additional employment can be obtained through State borrowing and spending with the comment, "By the renewed experience of full employment the dogma has been consumed by the fires of war, and the White Paper may be regarded as a ceremonial scattering of its ashes." Of course, what the Keynesians ignored with this line of reasoning was the fact that the classical model explains this phenomenon quite well. The combination of a positive shift in the money wage labor demand curve, a negative shift in the supply curve for labor (due to the shifting of people into the military), and the imposition of wage controls will produce this very same outcome in the classical model.

[7]Speaking to the Congress a few days after the Japanese surrender, then president Harry Truman said of the prospect of reconverting to peacetime conditions, "Obviously during the process there will be a great deal of inevitable unemployment." (as reported in the *New York Times*, September 7, 1945, p. 16). For a description of the economic forecasts of this period, see Sapir (1949).

[8]The evidence regarding the validity of the "pent-up" demand hypothesis is summarized in Vedder and Gallaway (1991).

[9]See Phillips (1958), Lipsey (1960), and Samuelson and Solow (1960) for details of the Phillips curve hypothesis.

[10]See Sargent and Wallace (1975) and Lucas and Rapping (1969) for examples of the rational expectations argument.

[11]In the 1920s, Eugen Slutsky (1927) demonstrated that the cumulative effect of a series of random shocks can lead to cyclical variations in economic activity.

[12]Similar ideas are expressed in Gallaway and Vedder (1987).

[13]The reference in von Mises Institute (1996) is to Hutt (1979). However, the ideas expressed there are something of an extension of the thinking expressed in *The Theory of Idle Resources.*

[14]While there are relatively few citations to *The Theory of Idle Resources*, references to the totality of Hutt's work have been sufficient to earn him a listing in Blaug (1986, pp. 420–421).

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